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Fiduciary Duties, Conflict of Interest and Proper Exercise of Judgment

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Abstract

One of the foremost problems of the fiduciary law theory is the imprecise understanding of what a situation of conflict of interest involves. The mainstream contemporary legal literature on fiduciary duties is premised on the dual assumption that, on the one hand, humans are inclined to act self-interestedly and, on the other hand, they are too weak consciously to resist this urge while managing another person's interests. Although these assumptions may be true in many cases of breach of fiduciary duties, they do not suffice to explain why fiduciary duties are imposed in situations where a fiduciary's good faith and honesty cannot be questioned. This article proposes a novel understanding of the notion of conflict of interest. Building on insights from cognitive psychology, behavioural economics and philosophy, this article defines a conflict of interest as the situation where a person, who has a duty to exercise judgment for the benefit of another, has an interest that tends to interfere with the proper exercise of his discretion. The emerging inter-disciplinary theory of conflicts of interest shows that personal or extraneous interests interfere with a decision-maker's judgment in unpredictable ways, and despite the decision-maker's honest efforts to keep them aside. This theory offers a more persuasive rationale for the existing strict fiduciary liability. It also offers a potent argument against the recent calls to relax the strict fiduciary regime in commercial contexts.

1. Introduction

John Byng was a well-reputed English Royal Navy admiral. In 1756 he was defeated by the French naval fleet in the battle for the Mediterranean island of Minorca. Although Admiral Byng had brought to the attention of his superiors the multiple causes of his failure, which included insufficient military personnel, damaged ships and failed communications, the public outrage demanded that Byng bear the blame. The following year, Byng was court-martialled, accused of "not doing his utmost" to prevent Minorca from falling to the French navy, and executed by firing-squad.¹ Byng's scapegoat execution led Voltaire to remark sarcastically:

¹ See Peter Burke, *Celebrated Naval and Military Trials* (London: W.H. Allen, 1866) 72–81.

“[D]ans ce pays-ci [Angleterre], il est bon de tuer de temps en temps un amiral pour encourager les autres.”²

Surprisingly, the practice that triggered Voltaire’s ridicule more than two centuries ago is nowadays invoked by courts and established fiduciary law scholars as the main justification for the onerous proscriptive duties that bind persons occupying a fiduciary position. In a recent decision of the England and Wales Court of Appeal, for example, Lady Justice Arden explained the severity of the proscriptive fiduciary duties by invoking the need to discipline fiduciaries, Admiral-Byng-style:

It may be asked why equity imposes stringent liability... [E]quity imposes stringent liability on a fiduciary as a deterrent – *pour encourager les autres*... [I]n the interests of efficiency and to provide an incentive to fiduciaries to resist the temptation to misconduct themselves, the law imposes exacting standards on fiduciaries and an extensive liability to account.³

The view that very strict duties are necessary in order to deter and discipline all fiduciaries is very common in fiduciary law literature. Robert Flannigan contended that only an indiscriminating, sledge-hammer, approach to conflicts of interest can eliminate fiduciaries’ incentive for opportunistic manipulation.⁴ Gareth Jones, another outstanding Equity scholar, shares this view. He contended that courts should be able to compel honest fiduciaries to disgorge unauthorized gains if they consider necessary to punish them, *pour encourager les autres*.⁵

The argument that the law must impose onerous proscriptive duties on all fiduciaries, regardless of their honesty, in order to deter them from succumbing to the temptation of easy gains is counterintuitive and cannot easily be accommodated within many influential frameworks of private law. This article offers a novel justification of the peculiar strictness of fiduciary duties, which is based on a more precise understanding of the notion of conflict of interest. The starting point of many fiduciary theories is that, because the fiduciary has scope for exercise of power or discretion, and is tempted to act self-interestedly, his self-regarding

² “In this country [England], it is advisable to kill an admiral from time to time to set an example for others.” (Voltaire, “Candide, ou L’optimisme” in Voltaire, *Romans* (Paris: Librairie Firmin Didot Frères, 1851) 113 at 172, my translation).

³ *Murad v. Al-Saraj* [2005] EWCA Civ 959 at [74].

⁴ Robert Flannigan, “The Strict Character of Fiduciary Liability” [2006] New Zealand Law Review 209 at 217: “Our sledge-hammer is designed to ‘*encourager les autres*’ generally (rather than selectively or sporadically) to give up any thought of unauthorized gain from manipulating the appearance of transactions or relations.”

⁵ Gareth Jones, “Unjust Enrichment and the Fiduciary’s Duty of Loyalty” (1968) 84 Law Quarterly Review 477 at 487.

interests come into conflict with beneficiary's interests. Equating conflict of interest with conflicting interests is an error that has obstructed the efforts to identify the proper role of the proscriptive duties and the underlying core features of all fiduciary relations.

Building on insights from cognitive psychology, behavioural economics and philosophy, this article defines a conflict of interest as the situation where a person, who has a duty to exercise judgment for the benefit of another, has an interest that tends to interfere with the proper exercise of his discretion. Conflict of interest situations affect the reliability of the decision-maker's judgment in ways that cannot be measured or corrected adequately. This theory offers a sound explanation for the peculiar harshness of fiduciary duties. The central reason for the strict duties is not preventing the temptation to steal or shirk, or disciplining the market, as the main current justifications hold, but preventing self-interest or other-regarding interests from interfering with fiduciary's core duty to exercise judgment based on relevant considerations. The proscriptive duties protect the beneficiary's right to the fiduciary's best judgment by preventing self-interest or other-regarding interests from interfering with the proper exercise of judgment.

The article proceeds as follows. Section 2 outlines the current legal framework of fiduciary duties, with a focus on the content of these duties and the main theoretical justifications of their strictness. It highlights the shortcomings of the dominant explanations for the strict fiduciary duties, namely the deterrence and vulnerability arguments. Deterrence and vulnerability, it is submitted, are unconvincing explanations because they misunderstand what lies at the core of a conflict of interest situation. They focus on the opposing interests between the parties to a fiduciary relation, rather than on the conflict between fiduciary's interests and his core duty to exercise proper judgment. Section 3 shows that the current misunderstanding of what a conflict of interest situation entails goes back to the early stages of fiduciary law development. It will also show that the interest-core judgment duty approach also existed in the early stages of fiduciary jurisprudence, but it was overshadowed by the conflicting interests justification of the strict fiduciary duties. Section 4 shows that the emerging inter-disciplinary theory of conflicts of interest validates the interest-core judgment duty approach. The danger of a conflict of interest situation, the emerging theory shows, resides in the risk of unreliable judgment caused by self-interest, rather than the risk of opportunism. Section 5 applies this insight into fiduciary law, and presents the positive and normative consequences of the interests-core duty approach to fiduciary conflicts of interest. The new theory advances the fiduciary law theory in three respects. First, it shows that the core fiduciary duty of proper judgment is essential for understanding the purpose of the strict

proscriptive fiduciary duties. Second, it provides cogent arguments against the recent calls for relaxation of the no-conflict and no-profit fiduciary rules. Third, it argues that the focus in fiduciary jurisprudence should shift from instructing fiduciaries to resist temptation to developing effective mechanisms to manage conflict of interest situations. Section 6 concludes.

2. The dominant view on the content and rationale of fiduciary duties

Fiduciary duties wield on common law scholars “something of the fascination... that the search for the Holy Grail had for the knights of Antiquity.”⁶ Like the quest for the Holy Grail, the search for the nature and content of fiduciary duties is complicated by the fact that scholars disagree on what precisely the expression fiduciary duty means.⁷

This section is a brief survey of the main theories concerning the content of fiduciary duties and the principal justifications for their existence. The dominant theory that emerged across common law jurisdictions is that fiduciary duties are a set of proscriptive duties that aim to prevent the temptation of self-interested acts to which certain private law actors are exposed. As will be shown throughout the following sections, this entrenched view of the content and purpose of fiduciary duties is a major obstacle to creating a sound principled foundation for the law of fiduciary duties.

2.1 When do fiduciary duties arise?

Fiduciary duties arise in fiduciary relations.⁸ Which relations are viewed in law as having a fiduciary character has been a contentious question for many decades. The traditional view of fiduciary relations is based on the idea that one person holds or controls property that in Equity belongs to another.⁹ Historically, only a limited number of relations were recognised by courts as fiduciary. Established fiduciary positions included trustees, guardians, executors,

⁶ Donovan Waters “Banks, Fiduciary Obligations and Unconscionable Transactions” (1986) 65 Canadian Bar Review 37 at 56.

⁷ Robert P. Austin, “Moulding the Content of Fiduciary Duties” in A.J. Oakley, *ed.*, *Trends in Contemporary Trust Law* (Oxford: Oxford University Press, 1996) 153 at 153.

⁸ Paul B Miller, “The Fiduciary Relationship” in Andrew Gold and Paul Miller, *eds.*, *Philosophical Foundations of Fiduciary Law* (Oxford: OUP, 2014) 63-90.

⁹ Andrew Hicks, “The Remedial Principle of *Keech v Sandford* Reconsidered” (2010) 69 Cambridge Law Journal 287.

agents, attorneys, corporate directors or officers, and partners.¹⁰ The traditional narrow approach has been gradually loosened. Today, courts and commentators across common law jurisdictions recognise that fiduciary relations are not restricted to powers over another's property. It is often acknowledged that the list of fiduciary relations is not closed.¹¹

The recognition of the open-ended nature of the family of fiduciary relations has created the need to identify the core elements that trigger the application of fiduciary duties in new relations. The problem of identifying the core elements of a fiduciary relation has been amply debated and, until recently, there was no sign of progress in sight.¹² Recent jurisprudential developments, however, have focused the analysis on two elements: undertaking to act for another and power or discretion to affect another's interests.¹³ These elements show that fiduciary duties arise where one person undertakes to perform a certain task or fulfil a certain position that requires exercise of judgment, or discretion, over another's interests. The requirement of undertaking to act for another signifies that fiduciary duties are triggered voluntarily. They are enforceable only against those persons who undertook to do something for the benefit of another person or for an abstract purpose.¹⁴ A discretionary power to affect the legal or practical interests of another is the second fundamental characteristic of fiduciary relations. The feature that qualifies the power requirement of a fiduciary relation is discretion. Although most scholars accept that fiduciaries have discretion,¹⁵ they interpret differently the meaning of this element and the way in which fiduciary duties control it.

Some scholars equate discretion with opportunities to cheat,¹⁶ to exploit other people's vulnerability¹⁷ or with enlarged scope for breach of non-fiduciary duties by fiduciaries.¹⁸

¹⁰ Austin W. Scott, "The Trustee's Duty of Loyalty" (1936) 49 Harvard Law Review 521 at 521.

¹¹ Canadian courts and commentators are the champions of the open-ended nature of fiduciary relations. See *Guerin v. The Queen* [1984] 2 SCR 335 at 384 per Dickson J; *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th.) 14 at 28 per La Forest J; *Cuthbertson v. Rasouli*, [2013] 3 SCR at [193] per Karakatsanis J. The context-driven approach to fiduciary relations is not limited to the Canadian common law. See *Hospital Products Ltd v. United States Surgical Corporation* (1984) 156 CLR 41 at 102 (Australia); Len Sealy, "Fiduciary Relationships" (1962) 20 Cambridge Law Journal 69 at 73 (UK).

¹² Peter Millet, "Equity's Place in the Law of Commerce" (1998) 114 Law Quarterly Review 214; Peter D. Maddaugh, "Definition of Fiduciary Duty", in *Special Lectures of the Law Society of Upper Canada, 1990, Fiduciary Duties* (Scarborough: The Law Society of Upper Canada, 1991) 15 at 16.

¹³ *Galambos v. Perez* [2009] 3 SCR 247; *Alberta v. Elder Advocates of Alberta Society* [2011] 2 SCR 261 at [36]; *Manitoba Metis Federation Inc. v. Canada (Attorney General)*, [2013] 1 SCR 623 at [50].

¹⁴ James Edelman, "When Do Fiduciary Duties Arise?" (2010) 126 Law Quarterly Review 302.

¹⁵ See Ernest Weinrib, "The Fiduciary Obligation" (1975) 25 University of Toronto Law Journal 1 at 4; Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Oxford: Hart Publishing, 2010) 247.

¹⁶ This view is prevalent in the law and economics analysis of fiduciary relations.

¹⁷ See e.g. *Lac Minerals Ltd. v. International Corona Resources Ltd* [1989] 2 SCR 574 at 599, per Sopinka J.; *Hodgkinson v. Simms* [1994] 3 SCR 377 at [130], per Sopinka and McLachlin JJ.

Therefore, in their view, fiduciary duties control discretion in the sense of removing temptations to gain unauthorized benefits. This understanding of discretion is erroneous. A decision whether to misappropriate or not is not an exercise of discretion in any meaningful sense of this concept. Exercising fiduciary discretion over another's interests means being in a position to adopt a decision in another person's interests, where there is no single pre-determined course of action, but where a fiduciary may choose from among a multitude of potential options, within the objective limits of his powers.¹⁹ Moreover, a fiduciary's discretionary power is not simply a power to alter the beneficiary's legal position. Many persons hold powers that affect the interests of others, without being bound by fiduciary duties in exercising them. Non-fiduciary, or personal powers, such as the power of appointment held in personal, rather than fiduciary capacity, the power to renew or terminate unilaterally a contract, or the power to accelerate repayment of a demand loan, change the legal position of others but are subject to lesser duties than fiduciary powers.²⁰

The discretionary fiduciary power is the authority to decide how to promote the best interests of the beneficiary, rather than simply the authority to decide whether to act or not in a pre-defined manner. In other words, the requirement of power is best understood as decision-making authority.²¹ Discretionary power, in the sense of decision-making authority, is a feature of fiduciary relations that is often acknowledged in the fiduciary law literature, but rarely fully grasped. As the subsequent sections will show, a correct understanding of the element of power is essential for understanding the notion of conflict of interest, and the content and role of fiduciary duties. A person having decision-making authority over the interests of another is bound by a core duty to exercise the authority by taking into account

¹⁸ See e.g. Conaglen, *supra* note 15 at 248. The central thesis of Conaglen's theory is that the no-conflict and no-profit principles provide a subsidiary and prophylactic form of protection to non-fiduciary duties. They increase the likelihood of a proper performance of the non-fiduciary duties, by seeking to avoid influences or temptations that are likely to interfere with the proper performance of the fiduciary's non-fiduciary duties. It is submitted that this is a variant of the traditional conflicting interests approach, with which this author disagrees. For critiques of Conaglen's theory see Rebecca Lee, "In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis" (2007) 27 Oxford Journal of Legal Studies 327; Deborah A. DeMott, "Disloyal Agents" (2007) 58 Alabama Law Review 1049; Joshua Getzler, "Am I My Beneficiary's Keeper? Fusion and Loss-Based Fiduciary Remedies" in Simone Degeling and James Edelman, eds., *Equity in Commercial Law* (Sydney: Thomson, 2005) 239.

¹⁹ See Lionel Smith, "Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on Behalf of Another" (2014) 130 Law Quarterly Review 608 at 610; Remus Valsan, "Fiduciary Duties of Credit Brokers: McWilliam v Norton Finance" (2016) 21 Edinburgh Law Review 99 at 103.

²⁰ Geraint Thomas, *Thomas on Powers*, 2nd ed (Oxford: OUP, 2012) 474.

²¹ Paul B. Miller, "A Theory of Fiduciary Liability" (2011) 56 McGill Law Journal 235 at 272-275; Paul B. Miller and Andrew S. Gold, "Fiduciary Governance" (2015) 57 William & Mary Law Review 513; Evan Fox-Decent, "The Fiduciary Nature of State Legal Authority" (2005) 31 Queen's Law Journal 259 at 301.

relevant considerations and omitting irrelevant ones.²² He also becomes bound by the proscriptive duties, which protect the decision-making process from the interference of conflicting interests or duties. As explained in the remaining parts of this section, the current mainstream fiduciary law theory focuses on the proscriptive duties independently of the decision-making feature of a fiduciary position. The failure to connect the two elements is the main cause of the persisting disagreements over the content and role of fiduciary duties.

2.2 What are fiduciary duties?

What do fiduciary duties require from a fiduciary? The content of fiduciary duties is a topic that has generated decades of debates and theories.²³

In a broad approach, fiduciary duties comprise the proscriptive no-conflict and no-profit duties and several prescriptive duties, such as the duty of good faith and or the duty of confidence.²⁴ This broad approach is flawed because it fails to identify a core feature or duty that applies only to fiduciary positions. It is generally agreed that not all duties owed by a fiduciary are fiduciary duties.²⁵ Duties of good faith, care, confidentiality or disclosure are often associated with a fiduciary position, but they apply to a wide spectrum of non-fiduciary legal actors as well.

A narrower approach separates the duties specific to persons in a fiduciary position into two main groups. On the one hand, there are the traditional proscriptive duties. On the other hand there is a core duty binding on fiduciaries, referred to by some authors as the duty of loyalty, which is different from the proscriptive duties and which justifies their existence. The proscriptive duties are connected with the core duty in the sense that they play a protective or prophylactic role: they aim to prevent violations of the fundamental fiduciary duty. The views differ, however, as concerns the content of the core duty. This duty has been defined as the duty to act (or to refrain from acting) with the proper motive,²⁶ the duty to

²² See Section 5.2 below.

²³ For a review of the main theories see See Leonard Rotman, *Fiduciary Law* (Toronto: Thomson Canada, 2005); Matthew Conaglen, *supra* note 15; Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981).

²⁴ Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co, 1977) 15-16. But see Paul D. Finn, “The Fiduciary Principle” in T.G. Youdan, *Equity, Fiduciaries and Trust* (Toronto: Carswell, 1989) 1 at 27-28 (equating the duty of loyalty to the proscriptive duties). This broad view is often criticised for confusing fiduciary duties with relating, but distinct doctrines (see Conaglen, *supra* note 15 at 214-244).

²⁵ See e.g. *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 at 597, per Sopinka J; *Wewaykum Indian Band v Canada*, [2002] 4 SCR 245 at [83], per Binnie J.

²⁶ Lionel Smith, “The Motive Not the Deed” in *Rationalizing Property, Equity, and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis UK, 2003) 53 at 55-56.

preserve and promote the interests of the beneficiary,²⁷ or the duty to look after and advance the beneficiary's interests.²⁸ Some commentators have even argued that the fiduciary duty of loyalty comprises a requirement to bring about an actual benefit for the beneficiary.²⁹

The theories connecting the proscriptive duties to a core fiduciary duty represent the only approach that can provide a cogent understanding of fiduciary relations. Nevertheless, these theories appear to be outside the current dominant understanding of the content of fiduciary duties. The main reason why these theories await due recognition is the fact that they do not offer persuasive explanations concerning *why* the core duty needs the special protection of the prophylactic duties. The justifications proposed by these theories for the need of this enhanced protection (such as the need to protect the beneficiary, to maintain the appearance of propriety, or the need to bypass evidentiary difficulties concerning the fiduciary's actual motive) resemble those of the strictly proscriptive approach, in the sense that they are external to the core duty. The theory developed in this article aims to fill this gap in our understanding of the content of fiduciary duties. Using the inter-disciplinary view of conflicts of interests,³⁰ it will show that the proscriptive no-conflict and no-profit duties protect the core fiduciary duty of exercising judgment based on relevant considerations.³¹

In a yet narrower approach, which is the dominant view, fiduciary duties are restricted to the proscriptive duties. The proscriptive duties are based two core rules: the no-profit rule and no-conflict rule.³² The no-profit rule forbids a fiduciary from retaining any unauthorised benefit acquired by virtue of his fiduciary position.³³ The no-conflict rule states that a fiduciary is not allowed to place himself in a position where his personal interest, or interest in another fiduciary capacity, conflicts or possibly may conflict with his duty.³⁴ Irrespective of their approach to the content of fiduciary duties, scholars are in agreement that the proscriptive duties are very strict.

²⁷ Peter Birks, "The Content of Fiduciary Obligation" (2000) 34 *Israel Law Review* 3 at 28

²⁸ Andrew Burrows, "We Do This at Common Law but That in Equity" (2002) 22 *Oxford Journal of Legal Studies* 1 at 8-9; Deborah DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" (1988) 5 *Duke Law Journal* 879 at 888.

²⁹ Deborah DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" [1988] *Duke Law Journal* 879 at 888. For a critique of the result-based approach see James Edelman, "When Do Fiduciary Duties Arise?" (2010) 126 *Law Quarterly Review* 302 at 322.

³⁰ This view is presented in Section 4 below.

³¹ The core fiduciary duty of exercising judgment based on relevant considerations is discussed in Section 5.2 below.

³² See Sarah Worthington, "Fiduciaries: When Is Self-Denial Obligatory?" (1998) 58 *Cambridge Law Journal* 500; A.J. McClean, "The Theoretical Basis of the Trustee's Duty of Loyalty" (1969) 7 *Alberta Law Review* 218 at 236; Conaglen, *supra* note 15. The self-dealing rule and the fair-dealing rule and often added to this list. See John Mowbray *et al*, eds., *Lewin on Trusts*, 18th ed. (London: Sweet & Maxwell, 2008) at [20-01].

³³ *Parker v. McKenna* (1874) LR 10 Ch App 96; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134.

³⁴ *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461; *Boardman v. Phipps* [1967] 2 AC 46.

The peculiar strictness of these duties has been the leitmotif of fiduciary law since the earliest reported cases.³⁵ Throughout the centuries, the courts have developed several facets to this specific severity of the proscriptive duties. One facet is the reprehensibility of the possibility of self-interested conduct. Fiduciaries have been held liable for breach of the no-conflict rule not only in case of an actual conflict between interest and duty, but also when there was a reasonable possibility of such a conflict.³⁶ In some cases, it has been argued that even the remote possibility of conflict is sufficient to find a breach.³⁷ Another manifestation of the strictness of the proscriptive duties is that fiduciary's liability does not depend on his good faith or actual motives, on the fact that the beneficiary has suffered no loss or has even obtained a benefit following the impugned transaction, or on the fact that the opportunity that the fiduciary has taken for himself was no longer available to the beneficiary.³⁸ Furthermore, the purchase by the fiduciary of property under his administration is voidable, even if the transaction appears to be entirely honest and fair.³⁹

2.3 Why are fiduciary duties so strict?

Within the confines of the dominant view of the content of fiduciary duties, the peculiar strictness of these duties is difficult to justify. Why are fiduciary's honesty and good faith irrelevant? Why are courts not even prepared to admit evidence that no harm was caused? Why is a fiduciary in breach of duty although the beneficiary suffered no apparent loss, or even benefitted from the conflicted transaction? The most frequent justifications of the strict fiduciary duties are the need to discourage even the mere temptation of selfish behaviour in fiduciaries (the deterrence argument), and the need to protect peculiarly vulnerable persons against abuse of their trust and confidence in others (the vulnerability argument). As the remaining part of this section shows, these explanations are unconvincing.

³⁵ See *Keech v. Sandford* (1726) Sel Cas Ch 61; *Forbes v. Ross* (1788) 2 Cox 112 at 116; *Parker v. McKenna* (1874) LR 10 Ch App 96 at 124-125; *Bray v. Ford*, [1896] AC 44 at 51

³⁶ *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461 at 471-472, per Cranwoth LC; *Bhullar v. Bhullar* [2003] EWCA Civ 424, per Parker LJ; *Item Software (UK) Ltd. v. Fassihi* [2004] EWCA Civ 1244, per Arden LJ.

³⁷ *Boardman v. Phipps* [1967] 2 AC 46 at 111 per Hodson LJ. It is generally agreed, though, that, for a potential conflict of interest to exist, there must be a reasonable possibility of such conflict, not a mere appearance of conflict. See *Marks and Spencer plc v Freshfields Bruckhaus Deringer* [2004] 3 All ER 773 at 777; Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, *Waters' Law of Trusts in Canada*, 3rd ed. (Toronto: Thomson Canada Ltd, 2005) 918.

³⁸ *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; [1967] 2 AC 134 at 144 per Lord Russell; *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461; *Boardman v. Phipps* [1967] 2 AC 46.

³⁹ *Robertson v Robertson* [1924] NZLR 552 at 553.

Deterrence is one of the most frequently invoked policy explanations for the strictness of the proscriptive duties, and, at the same time, one of the weakest arguments. Only indiscriminate punishment of actual and potential situations of conflict of interest, it is argued, can annihilate fiduciaries' incentives to take their chances and pursue unauthorized benefits.⁴⁰ Moreover, the role of fiduciary law is not to achieve a balance between the parties to a fiduciary relation, but to set an example and to encourage good behaviour, by insisting that nothing short of exemplary propriety on the fiduciary's part is allowed.⁴¹ Some authors have gone as far as claiming that fiduciary law is akin to the criminal law of theft or embezzlement, and should follow the latter's underlying policy.⁴²

The deterrence theory suffers from several major flaws. From a historical point of view, it is open to debate whether a policy of disciplining fiduciaries was the main reason for the introduction of these strict rules.⁴³ The landmark fiduciary law cases of the nineteenth century showed little or no concern for tracing the origin of these rules. They focused, instead, on expanding them to persons in trust-like positions, and on restating constantly the need to maintain their strictness. The deterrence explanation of fiduciary duties also lacks a clear connection to the core role of a fiduciary. Refraining from stealing, embezzling or converting another's property is not a duty that one has by virtue of occupying a fiduciary position. It is a general duty binding on all legal actors. The enhanced probability for such acts to occur in a fiduciary relation and the presumed irresistible temptation of self-interest motivating fiduciaries are not sufficient reasons to impose the particularly harsh proscriptive duties. Furthermore, the deterrence argument does not explain why no inquiry is allowed into the fiduciary's motives or good faith, once a reasonable possibility of conflict has been found to exist. If the law aims to deter fiduciaries from improperly using their powers, punishing an innocent fiduciary is not good deterrence.⁴⁴ The 'deterrence at all costs' approach would in fact produce the opposite results. Punishing the potentially innocent would signal to the guilty that what matters is not the actual guilt or innocence, but how their actions appear to the

⁴⁰ Robert Flannigan, "The Strict Character of Fiduciary Liability" [2006] *New Zealand Law Review* 209 at 217.

⁴¹ Gary Watt, *Trusts and Equity*, 2nd ed. (New York: Oxford University Press, 2006) 337-338 (stating that "[i]nsistence on exemplary fiduciary propriety encourages other persons in positions of trust to fulfil requirements of their office.")

⁴² Tamar Frankel, "Fiduciary Duties as Default Rules" (1995) 74 *Oregon Law Review* 1209 at 1223-1225. See also Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard: Harvard University Press, 1996) 92-104.

⁴³ See Section 3 below.

⁴⁴ For a thorough rebuttal of the deterrence argument see Lionel Smith, "Deterrence, Prophylaxis and Punishment in Fiduciary Obligations" (2013) 7 *Journal of Equity* 87.

outside world.⁴⁵ Finally, the idea that fiduciary law aims to discipline legal actors by deterring temptation sits ill with many influential private law theories.⁴⁶ The hallmark of private law is that it connects two particular legal subjects through the bias of liability. Private law focuses primarily on the bipolar relation between two legal subjects and not on the interests of the community as a whole.⁴⁷ Sound private law doctrine must approach this field from the inside, using a set of coherent fundamental legal concepts and a mode of reasoning typical to private law, and not in a functionalist manner, based on a set of extrinsic purposes. The promotion of desired social goals is not a principal intrinsic aim of private law, but a task attained mainly by other branches of law or social sciences.

Another justification of the strict fiduciary duties is the need to protect beneficiaries of fiduciary relations, which are peculiarly vulnerable to abuse. In *Lac Minerals Ltd. v. International Corona Resources Ltd*, for example, Sopinka J commented that vulnerability is the single indispensable requirement for the imposition of fiduciary duties.⁴⁸ In *Hodgkinson v. Simms*, Sopinka and McLachlin JJ, dissenting, restated their view that vulnerability, in the sense of extreme reliance, is the central element that generates the fiduciary duty.⁴⁹

The vulnerability theory is a weak explanation of the proscriptive duties. This theory is too broad because it encompasses situations of vulnerability that are the focus of other doctrines. The protection of the weak, vulnerable or disadvantaged could be seen as a secondary objective of fiduciary law, but it is too general to indicate the special nature of fiduciary duties. In *Galambos v. Perez*, Cromwell J., writing the unanimous decision, discarded the normative relevance of vulnerability.⁵⁰ He emphasized that vulnerability may be relevant insofar as it results from the relationship which creates the fiduciary duty, but a pre-existing situation of vulnerability is not an essential element for identifying the existence of a

⁴⁵ Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981) 144.

⁴⁶ Smith, *supra* note 44 at 92-93.

⁴⁷ For a detailed analysis of the goals of private law, see Ernest Weinrib, *The Idea of Private Law* (Harvard: Harvard University Press, 1995).

⁴⁸ *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 2 SCR 574 at 599. However, La Forest J., dissenting, argued that vulnerability could be a relevant circumstance only when determining if new classes of relationships should be taken to give rise to fiduciary obligations. In this sense, the vulnerability of the abstract class of beneficiaries of the obligation is a relevant consideration. Vulnerability cannot be a decisive element in finding a fiduciary obligation in a particular, ad hoc relation (*ibid.* at 663).

⁴⁹ *Hodgkinson v. Simms* [1994] 3 SCR 377 at [132]. La Forest J., writing for the majority, observed that vulnerability is a common theme to a multitude of equitable doctrines, and thus is not the hallmark of the fiduciary duty (*ibid.* at [25]). See also *Hospital Products Ltd. v. United States Surgical Corp.* (1984), 55 ALR 417 at 432, *per* Gibbs C.J. (arguing that the core reason for the existence of the principle is the special vulnerability of beneficiaries to abuse of power by fiduciaries).

⁵⁰ *Galambos v. Perez* [2009] 3 SCR 247.

fiduciary duty.⁵¹ Protection of inherently vulnerable persons is the main concern of other legal doctrines, such as unconscionability, undue influence or good faith.⁵²

It has also been claimed that vulnerability is relevant only as a factor that results from the fiduciary relation, rather than as a pre-existing feature of the beneficiary.⁵³ This is also too broad. In many contractual relations one party is vulnerable to an opportunistic breach by the other party. The greater the need for the latter's performance, and the more difficult it is to obtain a substitute, the greater the former's vulnerability.⁵⁴ Vulnerability to an opportunistic breach of contract, however, does not trigger super-imposed fiduciary duties not to act self-interestedly.

The shortcomings of the deterrence and vulnerability explanations of the strictness of fiduciary duties stem from their focus on the opposition between the fiduciary's and the beneficiary's individual interests. This understanding of fiduciary duties leaves unanswered the following fundamental question: what is so unique in the position of a fiduciary, that the law is concerned with removing temptation of self-interest and with preserving appearance of correctness? A proper understanding of the notion of conflict of interest, in the sense of incompatibility between a core fiduciary duty to exercise proper judgment and adverse interests, is fundamental for finding cogent answers to these questions.⁵⁵ As the next section will show, the idea that self-interest could affect a fiduciary's judgment (conflict between interest and duty) was recognized in the early fiduciary law theory. Unfortunately, commentators and judges lost sight of it as the policy justifications for preserving the strictness of fiduciary duties gained primacy. These justifications highlighted the need to discourage fiduciaries from being tempted to abuse their position, and the evidentiary difficulties that courts could face in trying to uncover the existence or the extent of fiduciary wrongdoing. These elements pointed to the opposition between the interests of the fiduciary and those of the beneficiary. As conflict of interest became synonymous with conflicting interests, the core judgment duty faded in the background. The theory developed in this article

⁵¹ *Ibid.* at [68].

⁵² See e.g. *Hodgkinson v. Simms* [1994] 3 SCR 377, at [26]-[27], per La Forest J.: See also See Paul D. Finn, "The Fiduciary Principle" in T.G. Youdan, *Equity, Fiduciaries and Trust* (Toronto: Carswell, 1989) 1; Jane Stapleton, "The Golden Thread at the Heart of Tort Law: Protection of the Vulnerable" (2003) 24 *Australian Bar Review* 135.

⁵³ Ernest J. Weinrib, "The Fiduciary Obligation" (1975) 25 *University of Toronto Law Journal* 1 at 6

⁵⁴ Daniel Friedmann, "The Efficient Breach Fallacy" (1989) 18 *The Journal of Legal Studies* 1 at 3; Timothy J. Muris, "Opportunistic Behavior and the Law of Contracts" (1981) 65 *Minnesota Law Review* 521.

⁵⁵ Very few contemporary fiduciary law scholars recognise that the essence of the no-conflict rule is the concern with reliable and unbiased judgment. See Smith, *supra* note 19 at 623; James Penner, "Is Loyalty a Virtue, and Even If It Is, Does It Really Help Explain fiduciary Liability" in Andrew Gold and Paul Miller, *eds.*, *Philosophical Foundations of Fiduciary Law* (Oxford: OUP, 2014) 159 at 167.

aims to resurrect the proper judgment duty, drawing on recent developments in cognitive sciences.

3. From conflict between interest and duty to conflicting interests: a historical overview

As the previous section showed, the fiduciary nature of the proscriptive duties and their peculiar strictness are generally accepted features of fiduciary law. The meaning of conflict of interest is the point where the different approaches to the nature and content of fiduciary duties start to diverge. In a loose, but frequent formulation, conflict of interest is used to refer to situations where the fiduciary's personal interests and the interests of the beneficiary point in opposite directions.⁵⁶ In a more precise approach, conflict of interest is understood as the opposition between the fiduciary's interests and his duty. Very often, the duty side of the conflict of interest is interpreted broadly, as encompassing all duties that a fiduciary owes.⁵⁷ Consequently, although it refers to a conflict between interest and duty, this understanding of a conflict of interest is very similar to the conflicting interests approach: the fiduciary duty must prevent fiduciaries from being swayed by self-interest from the proper performance of all their duties to beneficiaries.

The failure to understand properly the core conflict that is specific for persons in a fiduciary position is a chronic problem of fiduciary law. As it will be discussed below, since the very early stages of the development of rules concerning trustees and other fiduciaries, judges and commentators emphasised the need to preserve and enhance the disciplining effect of the proscriptive duties. Few jurists probed deeper into the role that these duties serve in connection to a fiduciary's essential role. Several scholars of the 18th century observed that the strict fiduciary prohibitions aim to prevent self-interest from distorting the fiduciary's judgment. This is important for the theory developed in this article. It suggests that the essence of the current inter-disciplinary view of conflicts of interest, which opposes extraneous interests and the proper exercise of judgment, was known to early fiduciary law jurists. Throughout the 19th century, however, this insight seems to have been lost, and public policy arguments became the most prominent justification of the need to control fiduciaries.

⁵⁶ See e.g. Paul B. Miller, "Justifying Fiduciary Remedies" (2013) 63 University of Toronto Law Journal 570 at 605; Irit Samet, "Guarding the Fiduciary's Conscience: A Justification of a Stringent Profit-stripping Rule" (2008) 28 Oxford Journal of Legal Studies 763 at 765; Tamar Frankel, "Fiduciary Law" (1983) 71 California Law Review 795 at 811.

⁵⁷ See Section 2.2 above.

As the focus shifted away from the need to ensure a proper exercise of judgment to the need to prevent temptation of abuse, courts and commentators referred to the conflict specific to persons in a fiduciary position in an imprecise manner, by using interchangeably the ideas of conflicting interests and conflict between interest and duty.

*Keech v. Sandford*⁵⁸ is among the earliest cases that appear to provide support for the deterrence theme. In this “extraordinarily cryptic case,”⁵⁹ Lord Keeper King emphasized that trustees are strictly prohibited from taking in their own name a lease no longer available to the beneficiary of the trust. The decision provides a strong warning against trustees not to use the office for their own benefit.⁶⁰ The peculiar strictness of this rule has two manifestations. First, Lord Keeper King argued that it is preferable to abandon a lease that could not be renewed for the benefit of the beneficiary, rather than allow the trustee to take it in his own name. Second, a trustee who takes over such a lease is liable to hold it for the benefit of the beneficiary, although he was not motivated by the desire to defraud the beneficiary.⁶¹

In the absence of a more detailed reporting of this case, it is difficult to identify the underlying reason for the harshness of this rule binding trustees and other fiduciaries. The elusive reporting suggests that Lord Keeper King invoked the deterrence theme not as the explanation for why these duties had been established in the first place, but as an important reason for maintaining their strictness. His assertion that the rule “should be strictly pursued, and not in the least relaxed”⁶² seems to imply that, by the time of that decision, the strict prohibition of self-interest for persons in a position of trust was already an established and rigid rule. Historically, however, the case has been received as establishing a preventive

⁵⁸*Keech v. Sandford* (1726) Sel Cas Ch 61.

⁵⁹ Joshua Getzler, “Rumford Market and the Genesis of Fiduciary Obligations” in A Burrows and Lord Rodger of Earlsferry, eds, *Mapping the Law: Essays in Honour of Peter Birks* (Oxford Oxford University Press, 2006) at 581. For historical insights into the rationale behind *Keech* see Walter G. Hart, “The Development of the Rule in *Keech v Sanford*” (1905) 21 Law Quarterly Review 258; Stephen Cretney, “The Rationale of *Keech v. Sandford*” (1969) 33 Conveyancer 161; Dennis R. Paling, “The Pleadings in *Keech v. Sanford*” (1972) 36 Conveyancer 159.

⁶⁰*Keech v. Sandford* (1726) Sel Cas Ch 61.

⁶¹ *Ibid.* The strict rule established in *Keech* was subsequently extended beyond leases, to a general prohibition from obtaining unauthorised benefits binding on persons in a fiduciary position. See Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees*, 2nd ed. (London: Maxwell, 1842) 179 (noting that the *Keech* principle applies to factors, agents or other “confidential persons”); Frederick T. White and Owen D. Tudor, *A Selection of Leading Cases in Equity: With Notes*, ed. by Thomas Snow et al., vol. 2, 7th ed. (London: Sweet and Maxwell, 1897) 695 (stating that *Keech* applies to any “person clothed with a fiduciary or quasi fiduciary character or position”).

⁶² *Keech v. Sandford* (1726) Sel Cas Ch 61.

sanction that takes away all incentive for a fiduciary to consider how he might gain from his position.⁶³

Another early use of the deterrence argument comes from Lord Kames. In his treatise on Equity, Kames argued that allowing trustees to draw direct or indirect benefits from their position would have “poisonous” consequences and would make trustees “lose sight of their duty”.⁶⁴ Although he mentioned the dangers that self-interest poses to trustee’s duty, Lord Kames did not elaborate on the particular duty that is peculiarly susceptible to be breached by self-interest. Nevertheless, he made a valuable, albeit insufficiently detailed, and often overlooked, observation. He asserted that the principle that prohibited trustees or tutors from purchasing property under their management was the same principle that prohibited persons occupying a judicial office from purchasing land that is subject of a lawsuit:

It is for the same reason that a member of the college of justice is prohibited by statute from purchasing land the property of which is subject to a law-suit; and that a factor upon a bankrupt estate is prohibited from purchasing the bankrupt’s debts.⁶⁵

It is very likely that the principle to which Lord Kames alludes is the natural justice maxim that no person can be judge in his own cause (*nemo iudex in causa sua*). Stated differently, the maxim prohibits a person required to exercise impartial judgment to have a personal interest in the outcome of his decision.⁶⁶ The prohibition to be both judge and interested party in the same cause goes back to Roman times. Section 2.2 of the Theodosian Code entitled “No person shall be judge in his own cause” (*Ne in sua causa quis iudicet*) states that “no person shall act as judge for himself.”⁶⁷ The *nemo iudex in causa sua* formulation of the prohibition

⁶³ Getzler, *supra* note 59 at 586. In *Whelpdale v. Cookson* (1747) 1 Ves 8 Lord Chancellor Hardwicke made a similarly elusive reference to the core justifications of the strictness of the proscriptive rules, by invoking the need to prevent unwanted consequences on other fiduciary relations and the evidentiary difficulties related to proving an actual benefit. Likewise, in *Fox v. Mackreth* (1788) 2 Cox 320 Lord Thurlow stated that in cases where trustees acted honestly in self-dealing transactions the proscriptive duties must be maintained based on “the rules of a Court of Equity, from general policy, and not from any peculiar imputation of fraud.” (*ibid.* at 326).

⁶⁴ Lord Henry Home Kames, *Principles of Equity*, vol. 2, 2nd ed. (Edinburgh: A. Kincaid & J. Bell, 1767) 255.

⁶⁵ *Ibid.* at 256.

⁶⁶ See *Hall v. Harding* (1769) 4 Burr 2426 at 2431: “[W]hen the question depends upon ... a matter of judgment, the party interested can never be a competent judge in his own cause.” See also John Erskine, *An Institute of the Law of Scotland*, vol.1 (Edinburgh: John Bell, 1773) 45, emphasis added: “Declinature is founded, thirdly, *ratione suspecti iudicis*, where either the judge himself, or his near kinsman hath an interest in the suit. It is a rule founded on nature itself, that no man ought to judge in his own cause; and it holds, though the judge have only a partial interest in the cause...”

⁶⁷ *The Theodosian Code and Novels and the Sirmondian Constitutions*, trans. by Clyde Pharr (Princeton: Princeton University Press, 1952) 39-40. The official interpretation of this text underlines that the reason why a person cannot be judge in a matter in which he is interested is the same reason that prohibits a person to be witness in a case where he has an interest (*ibid.* at 40).

of being judge in one's own case was coined in the 17th century by Sir Edward Coke.⁶⁸ This prohibition was invoked by several other treatises and court decisions in the late 18th century as the core justification of the proscriptive fiduciary rules. John Erskine, for example, provided a similar explanation for the civil law rule that prohibits tutors and curators from obtaining a personal benefit in relation to their position:

Neither tutors nor curators can be *auctores in rem suam*. They cannot, contrary to the nature of their trust, interpose their authority to any deed of the minor, in which themselves have an interest, or which tends to produce an obligation against him in their own favour, *more than they can be judges or witnesses in their own cause*....⁶⁹

Just like Kames, Erskine connected the strict prohibition of self-interest with the established natural law prohibition of being both judge and party in the same case, without further explaining how the natural law maxim applies in the particular context of a fiduciary position.⁷⁰

The *nemo iudex* maxim was well-known to the 18th century jurists. It was regarded as a general rule of law, founded on nature and known to all legal systems.⁷¹ As part of natural justice, the maxim was firmly established in the context of judicial decision-making, where it embodied the principle that a person adjudicating should be disinterested and unbiaised.⁷² In the context of fiduciary duties, due to the absence of explicit statements connecting the prohibition of self-interest to the proper exercise judgment, the *nemo iudex* explanation for the strict fiduciary prohibitions passed largely unnoticed. The subsequent cases have emphasised

⁶⁸ Sir Edward Coke, *The First Part of the Institutes of the Law of England*, vol. 1, 15th ed. (London: E. and R. Brooke, 1794) 229. See also David E.C. Yale, "Iudex in Propria Causa: An Historical Excursus" (1974) 33 Cambridge Law Journal 80 at 80.

⁶⁹ John Erskine, *An Institute of the Law of Scotland: In the Order of Sir George Mackenzie's Institutions of That Law*, vol. 1 (Edinburgh: John Bell, 1773) 123, emphasis added. See also *Aitken v Hunter* (1871) 9 M 756 at 762 per Lord Neaves (stating that no fiduciary is allowed to become *auctor in rem suam*). The *auctor in rem suam* and the *nemo iudex* rules share the same underlying rationale, namely the prohibition to act as both judge and party in the same cause. See Patrick Fraser, *A Treatise on the Law of Scotland Relative to Parent and Child and Guardian and Ward*, 2nd ed. (Edinburgh: T. & T. Clark, 1867) 279; James Avon Clyde, transl., *The Jus Feudale by Sir Thomas Craig of Riccarton*, vol. 1 (Edinburgh: William Hodge, 1934) 292.

⁷⁰ *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42 is another early landmark fiduciary law decision that connects the strict prohibition of self-dealing by trustees with the *nemo iudex* rule: "The ground on which the disability or disqualification rests, is no other than that principle which dictates that a person cannot be both judge and party." (*ibid.* at 63, emphasis added).

⁷¹ *Mersey Docks Trustees v. Gibbs*, (1886) L.R. 1 H.L. 93 at 110 ("[I]t is contrary to the general rule of law, not only in this country [England] but in every other, to make a person judge in his own cause."). See also *Gibbons v. Bishop of Cloyne*, Holt 599 at 600 ("Lastly, here the bishop was both judge and party, which is not to be allowed by any law in the world."); Steward Kyd, *A Treatise on the Law of Awards* (Dublin: J. Stockdale, 1791) 42: ("It is a general rule of law, founded on the first principles of natural justice, that a man cannot be judge in his own cause.")

⁷² See Harry Woolf *et al.*, *De Smith's Judicial Review*, 7th ed. (London: Sweet & Maxwell, 2013) 536-538.

the dangers of temptation to act self-interestedly, but have lost sight of the insight that temptation must be avoided in order to ensure proper judgment.

The decisions issued by Lord Eldon at the beginning of the nineteenth century have played a key role in the establishment of the ‘danger of temptation’, ‘security against discovery’ and ‘primacy of principle’ themes as the most prominent justifications of the proscriptive duties.⁷³

In *Ex parte Lacey*⁷⁴ Lord Eldon asserted that assignees under a commission of bankruptcy cannot purchase an interest the bankrupt’s estate sold under the commission. This prohibition does not depend on the morality of a particular transaction, but rests on the general principle that fiduciaries cannot do “any thing for their own benefit,” irrespective of the apparent honesty of the transaction.⁷⁵ The general principle is justified by the difficulty of proving the actual fairness of each transaction in which the fiduciary has a personal interest. Consequently, for policy reasons, transactions that are not morally reprehensible must be sacrificed in order to ensure the effectiveness of the ‘principle’.⁷⁶

In *Ex parte James*⁷⁷ Lord Eldon reiterated the view that purchases by trustees and other persons in trust-like positions of property under their administration should be strictly prohibited in all instances, irrespective of the trustee’s honesty and regardless of whether the trustee has obtained or not an advantage from the sale.⁷⁸ By virtue of their position, trustees acquire detailed knowledge of the value of the property they administer, which puts them in a strategic position to use this information for their own benefit while maintaining the appearances of fairness. Consequently, a strict deterrent principle is required for all trustees, even if in some cases the application of this principle causes losses to trust beneficiaries. The deterrence theme and the evidentiary difficulty theme are combined to justify the strictness of the proscriptive duties.⁷⁹ The only scenario in which courts are willing to scrutinize the merits of a transaction in which a trustee, in his private capacity, acquires a benefit in relation to the trust property is if the trustee resigns this office with the beneficiary’s free and fully informed consent.⁸⁰

⁷³ These ideas appear also in *Lister v. Lister* (1802) 6 Ves Jun 631 at 631-633, where Sir W. Grant, Master of the Rolls asserted that the no-conflict rule “is a rule of general policy, to prevent the possibility of fraud and abuse; for it may not always be possible to know whether property was undersold.”

⁷⁴ *Ex parte Lacey* (1802) 6 Ves Jun 626.

⁷⁵ *Ibid.* at 628.

⁷⁶ *Ibid.* at 626-627.

⁷⁷ *Ex parte James* (1803) 8 Ves Jun 338.

⁷⁸ *Ibid.* at 345.

⁷⁹ *Ibid.* at 348-349.

⁸⁰ *Ibid.* at 352-353.

In *Ex parte Bennett*,⁸¹ Lord Eldon observed that the rule against profits applied to trustees and other fiduciaries does not depend on an actual benefit accruing to such persons. Any possibility of benefit must be removed due to the courts' limited fact-finding powers and to protect "the safety of mankind".⁸² Beside his traditional arguments, Lord Eldon provided another explanation for the need to proscribe self-dealing. He observed that, once a trustee allows a personal interest to arise in himself in relation to a duty that he must discharge for the benefit of the beneficiary, due to "human infirmity" the trustee will not be able to prevent such interest from interfering with the optimal discharge of his duty.⁸³

Once it became settled that the absolute prohibition of self-interested acts has primacy over the actual circumstances of the case, the courts refused to allow any suggestion being raised that the self-interested transaction may be fair to the beneficiary. In *Wormely v. Wormely*,⁸⁴ Johnson J. of the U.S. Supreme Court asserted that the issue of the fairness of a self-dealing transaction cannot be taken into account by the court:

[A] trustee shall not be permitted to mix up his own affairs with those of the cestui que trust. *Those who have examined the workings of the human heart* well know that in such cases, the party most likely to be imposed upon is the actor himself, if honest, and if otherwise, that the scope for imposition given to human ingenuity will enable it generally to baffle the utmost subtlety of legal investigation.⁸⁵

The language in *Wormely* and in some of the cases analyzed previously suggests that the strict proscriptive rules are meant to prevent not only situations where fiduciaries yield to temptation and use their human ingenuity to hide the unauthorized benefit from the eye of the court, but also the cases where, due to the limitations of the human conscience or heart, self-interest tends to interfere with the proper discharge by a fiduciary of his duty. In *Hamilton v. Wright*,⁸⁶ Lord Brougham underlined that the focus of the rule against conflicts of interest is the tendency that self-interest has to interfere with the trustee's duty to the trust:

There cannot be a greater mistake than to suppose... that a trustee is only prevented from doing things which bring an actual loss upon the estate under his administration.

⁸¹*Ex parte Bennett* (1805) 10 Ves Jun 382.

⁸²*Ibid.* at 385-396.

⁸³*Ibid.* at 394, emphasis added.

⁸⁴*Wormely v. Wormely* (1823) 21 US 8 Wheat 421.

⁸⁵*Ibid.* at 464, emphasis added. Johnson J's reference to 'the workings of the human heart' may betray influences of natural law or natural justice philosophical ideas, where heart and conscience were closely-linked concepts. See generally Dennis R. Klinck, *Conscience, Equity and the Court of Chancery in Early Modern England* (Surrey, England: Ashgate Publishing, 2010) 199.

⁸⁶*Hamilton v. Wright* (1842) 9 Cl & Fin 111.

It is quite enough that the thing which he does has a tendency to injure the trust; a *tendency to interfere with his duty*.⁸⁷

Regrettably, Lord Brougham's argument shifted to the traditional justifications of the prohibition of self-interested acts. He referred to the need to prevent trustee's misuse of information for his own benefit, the court's inability to ascertain when such misuse occurs,⁸⁸ and the need to sacrifice potentially honest transactions in order to prevent the greater evil of undetected misbehaviour, without further clarifications concerning how self-interest tends to interfere with the trustee's duty.

The idea that any investigation into the actual fairness of a conflicted transaction is inadmissible ascribed a procedural nature to the proscriptive rules, and obscured further their connection with a core duty. Whenever a conflict of interest existed, no further investigation into the substantial merits of the transaction was allowed or required.⁸⁹

The increasing emphasis on the procedural nature of the proscriptive rules and on their inflexibility led to a further overshadowing of the core reason for which they were established. Although some landmark decisions referred to a conflict between interest and duty, the general explanation of the strict proscriptive duties tended to focus exclusively on the need to counteract the inherent tendency of the human nature to yield to the temptation of selfishness. The idea that the strict proscriptive rules are the expression of a policy aimed to prevent fiduciaries from being tempted to act self-interestedly has survived to the present day as the most conspicuous explanation of the fiduciary duty.⁹⁰

The focus on the need to prevent self-interest led to a distortion of the idea of conflict of interest. Consequently, it became habitual to refer interchangeably to conflict between interest and duty or to conflicting interests, without a clear understanding of the particular nature of the conflict that is specific for fiduciaries. This inappropriate understanding of the core fiduciary conflict appears in the earliest treatises on equity. In his annotations to one of the earliest Equity treatises (*A Treatise on Equity*, nominally ascribed to Henry Ballou), John

⁸⁷ *Ibid.* at 122-123, emphasis added. See also Joseph Story, *Commentaries on Equity Jurisprudence as Administered in England and America*, vol. 1, 6th ed. (Boston: Little, Brown, 1853) 361-362.

⁸⁸ The difficulties of proving fiduciary's wrongdoing is an argument often invoked in the early fiduciary case law as a justification for maintaining the strictness of the fiduciary duties (see e.g. *Whelpdale v. Cookson* (1747) 1 Ves 8). This argument lost its force over time. The modernization of civil procedure and the comprehensive requirements regarding appropriate recordkeeping by certain fiduciaries have alleviated to a great extent the evidentiary difficulty problem (see e.g. John H. Langbein, "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 Yale Law Journal 929 at 987-990).

⁸⁹ *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461, at 471-472. See also *Parker v. McKenna* (1874) LR 10 Ch App 96 at 118.

⁹⁰ See e.g. Conaglen, *supra* note 15 at 73 (stating that the main aim of fiduciary law is to insulate the fiduciary from the temptation of acting self-interestedly)

Fonblanque emphasized that the strict prohibitions to which Equity subjects trustees are meant to keep them “within the line of their duty” by preventing their personal interest from entering into conflict with that of the beneficiary.⁹¹

Alternating references to conflict between interest and duty and conflicting interests are also found in *Aberdeen Railway Co v Blaikie Brothers*,⁹² one of the early landmark cases of fiduciary law. Lord Cranworth famously stated that no person who has having fiduciary duties to discharge is allowed to have, “a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.”⁹³ Shortly thereafter, he explained that the “very evil” against which the strict no-conflict rule is designed is the situation where a fiduciary acquires a personal interest that leads in the opposite direction as that of his duty.⁹⁴

Although the conflicting interests understanding is prevalent, the notion of conflict of interest in the sense of opposition between extraneous interests and duty to exercise judgment is not altogether absent from the court decisions. Several courts and commentators have explained the irrelevance of fiduciary’s good faith and desire to resist temptation in a situation of conflict of interest by underlining the insidious ways in which the possibility of self-interest affects the fiduciary’s judgment. Similarly to the proponents of the contemporary philosophical view of conflicts of interest, which will be explained in the following section, these jurists recognize that a situation of conflict creates a risk on the fiduciary’s judgment that cannot be measured or controlled.

In *Re Trusteeship of Stone*, for example, Zimmerman J. of the Supreme Court of Ohio observed that the reason why a trustee is in breach of duty of loyalty for self-dealing, although he acted in good faith, is the need to keep aside factors that tend to interfere with the reliability of his judgment:

[The self-dealing rule] may seem a harsh rule when applied to instances where there is no studied or deliberate design to do wrong and when the [investment activity] is conceived and executed in good faith. [A fiduciary] must refrain from... doing those

⁹¹ Henry Ballow, *A Treatise of Equity with the Addition of Marginal References and Notes by John Fonblanque*, vol. 2, 4th ed. (Brookfield, Mass: E&L Merriam, 1835) 445. See also Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees*, 1st American ed. (Philadelphia: John S. Littell, 1839) 146-147; Leopold G. Robbins, *Bytherwood & Jarman’s System of Conveyancing: A Selection of Precedents in Conveyancing*, vol. 5, 4th ed. (London: H. Sweet, 1888) 96.

⁹² *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461.

⁹³ *Ibid.* at 471-472, emphasis added.

⁹⁴ *Ibid.* at 472, emphasis added.

things which would *tend to interfere with the exercise of a wholly disinterested and independent judgment*.⁹⁵

Re Skeats's Settlement is one of the rare cases linking the *nemo iudex* rule with the idea of biased judgment. In this case, the donees of a fiduciary power granting them authority to appoint “any other person” as trustee exercised the power to appoint themselves. Since the power was fiduciary in character, Kay J. held that the exercise of discretion was invalid:

The universal rule is that a man should not be judge in his own cause; that he should not decide that he is the best possible person, and say that he ought to be the trustee. Naturally *no human being can be imagined who would not have some bias one way or the other as to his own personal fitness*, and to appoint himself among other people, or excluding them to appoint himself would certainly be an improper exercise of any power of selection of a fiduciary character such as this is.⁹⁶

In a similar vein, Justice Earl Hoover, writing extra-judicially, explained that a fiduciary's honesty and good intentions are no defence to a breach of the proscriptive duties because “his judgment is so warped that he cannot be fair.”⁹⁷

As these examples illustrate, a precise understanding of the notion of conflict of interest, in the sense of opposition between the decision maker's personal interests and his exercise of judgment is not altogether absent from the evolution of the fiduciary law. This understanding, however, has been obscured by the view advocating the need to prevent temptations of unauthorized benefits, and to protect vulnerable beneficiaries. Besides failing to acknowledge the biasing effect that extraneous interests have on fiduciary's judgment, the dominant theory of fiduciary obligations also obscures the fiduciary's duty to exercise discretion based on relevant considerations. The prevention of risk of bias and the duty to take into account relevant considerations are different facets of the same concern: the protection of beneficiary's right to the fiduciary's best judgment. The following section will show that this understanding of what a situation of conflict of interest is, and why it is dangerous for those exercising discretion over another's interests, is well established in the emerging

⁹⁵ *Re Trusteeship of Stone* (1941) 138 Ohio St 293 at 302, emphasis added. See also *Pyle v. Pyle*, 137 App Div 568, 572, 122 NYS 256 [1910], aff'd 199 NY 538, 92 NE 1099 [1910]: “The purpose [of fiduciary duties] is to require a trustee to assume a position where his every act is above suspicion and the trust estate, and it alone, can receive, not only his best services, but his unbiased and uninfluenced judgment.”; *Thurston v. Nashville & American Trust Co.*, 32 F Supp 929 (MD Tenn 1940): the proscriptive duties guarantee that fiduciaries “shall at all times have the benefit of unbiased and disinterested judgment of the trustee [...]”

⁹⁶ *Re Skeats's Settlement* (1889) 42 Ch D 522 at 527, emphasis added.

⁹⁷ Earl R. Hoover, “Basic Principles Underlying Duty of Loyalty” (1956) 5 Cleveland-Marshall Law Review 7 at 16.

interdisciplinary theory of conflicts of interest. This article aims to bridge the gap between fiduciary law and the interdisciplinary view of conflicts of interest. After reviewing the emerging standard view of conflicts of interest, it will explore the positive and normative consequences of incorporating the standard view into fiduciary law theory.

4. Conflict of interest and proper exercise of judgment: an interdisciplinary approach

The connection between self-interest and proper exercise of discretion is a theme explored in detail by the emerging social sciences literature on conflicts of interest. The previous section showed that this understanding of a fiduciary conflict of interest existed in the background of the 18th and 19th century fiduciary law. References to the *nemo iudex* rule, or to the tendency of self-interest to influence the exercise of fiduciary's duty, seem to point to the same central idea: the mere presence of self-interest affects the proper exercise of judgment. Contemporary research into decision-making processes provides a more solid understanding of this phenomenon. Building on empirical psychological and economic research, cognitive and behavioural researchers from various areas of social sciences have contributed to the emergence of an interdisciplinary 'standard view' of the notion of conflict of interest.

The standard view is centred on the idea that the personal interests or preferences of a person in a position to exercise judgment in the service of another may affect the reliability and credibility of this person's judgment, by interfering, consciously or subconsciously, with the person's ability to give fair and genuine consideration to factors that are relevant in adopting a decision. When a decision requires judgment, extraneous interests could influence the decision process by tending to make the decision-maker's judgment less reliable than it normally is, without rendering it incompetent.

The standard view of conflict of interest brings significant clarifications into the mechanism of adopting decisions on another's behalf and offers valuable tools for the advancement of the legal theory of fiduciary duties. Building on consistent empirical evidence, it demonstrates that personal interests tend to affect the decision-making process in ways that are beyond the decider's control, and indeed beyond any form of objective assessment.

4.1 The standard view on conflicts of interest

In the latter half of the twentieth century, a “minor revolution” took place in the understanding of conflicts of interest and the most appropriate strategies to manage them.⁹⁸ Breaking off with the traditional view, which advocated the resolution of conflicts between interest and duty by resisting the temptation of selfish acts, the new theory reveals that external interests can affect the judgment of even the most honourable and disciplined persons. Consequently, avoidance or management of conflict situations, rather than abstention, is the desirable course of action.

The traditional ethical view of conflict situations adopted a virtue-centric approach. A person faced with a choice between interest and duty was expected to do the right and honourable thing and resist the temptations of selfishness. As long as this person remained virtuous and fulfilled his primary duties, nothing morally wrong occurred.⁹⁹ The main flaw of this view is that it overestimates the ability of conflicted individuals to know if their judgment has been affected by the interfering interest. The modern view overcomes this flaw by recognising that a person is in a conflict of interest on the basis of being in a conflicted situation, irrespective of the person’s belief that he is capable of resisting the temptation or corrupting influence of the interest that could interfere with his judgment.¹⁰⁰

The traditional ethical view of conflict situations coincides with the dominant legal justification of fiduciary duties. In both fields, how a person responds to a situation of conflict tends to be regarded exclusively as a matter of incentives and conscious choice: the rightful course of action is to resist temptation, while the wrongful option is to act opportunistically.¹⁰¹

The standard view of conflict of interest is built on recent developments concerning decision-making processes made in cognitive sciences. It has been demonstrated that interests affect the way in which a person evaluates the seriousness of various risks, the desirability of

⁹⁸ Wayne Norman and Chris MacDonald, “Conflicts of Interest” in George Brenkert and Tom Beauchamp, *eds.*, *The Oxford Handbook of Business Ethics* (Oxford: Oxford University Press, 2010) 441 at 459.

⁹⁹ *Ibid.* at 447.

¹⁰⁰ “What we now recognize is that [the traditional ethical view] is naïve: conflicted individuals can have their judgment interfered with even when they try their best to ‘correct’ for the influence of the conflicting interest... In many cases they may not even be aware of the influence some source of bias may have over them...” (*ibid.* at 461).

¹⁰¹ See Don A. Moore, Lloyd Tanlu and Max H. Bazerman “Conflict of Interest and the Intrusion of Bias” (2010) 5 *Judgment and Decision Making* 37 at 46-47 (stating that the dominant view in fields like business, accounting, and law, according to which bias is a matter of deliberate choice is challenged by psychological research which suggests that biased information processing pervasive, unconscious and unintentional).

certain outcomes, or the perception of connections between cause and effect.¹⁰² Consequently, conflict of interest situations are reprehensible not because they create a measurable bias, but because they create an “unusual *risk* of error,”¹⁰³ thus rendering one’s judgment less reliable.¹⁰⁴

The literature on cognitive and motivational biases provides detailed theoretical and empirical information on the ways in which personal interests can interfere with the judgment or motivation of a person. The inter-disciplinary understanding of the ways in which interest affects judgment is based on a long-standing distinction drawn by psychologists between two different modes of information processing that characterize human cognition. On the one hand, there are automatic cognitive processes that are relatively effortless and unconscious. On the other hand, there are controlled processes, more analytical and more effortful. Automatic and controlled processes often act in concert to produce judgments and decisions, but in certain predictable situations they can come into conflict. In the case of professionals, the two different modes of thinking are illustrated by two different sets of motives: professional responsibilities and personal interests. As is the case of automatic and controlled processes, these motives often coincide and reinforce each other. When professional responsibilities and self-interest point in opposite directions, however, self-interest exerts a more automatic influence than professional responsibilities, which are more likely to be governed by controlled processing. Since automatic processing tends to occur outside of conscious awareness, its influence on judgment and decision-making is difficult to eliminate or correct entirely. Consequently, self-interest often prevails, even when decision-makers consciously attempt to comply with the rules regulating their role or profession.¹⁰⁵

¹⁰² Michael Davis, “Empirical Research on Conflict Of Interest: A Critical Look” in Anne Peters and Lukas Handschin eds., *Conflict of Interest in Global, Public and Corporate Governance* (Cambridge: Cambridge University Press, 2012) 54.

¹⁰³ Michael Davis, “Conflict of Interest” in Ruth Chadwick, ed., *Encyclopedia of Applied Ethics*, vol. 1 (London: Academic Press, 1998) 589 at 589, emphasis added.

¹⁰⁴ Norman and MacDonald, *supra* note 98 at 464 (stating that conflicting personal and even professional interests can impair the judgment of even the most dedicated and conscientious expert). See also Don A. Moore and George Loewenstein, “Self-Interest, Automaticity, and the Psychology of Conflict of Interest” (2004) 17 *Social Justice Research* 189 at 189 (arguing that, since violations of professionalism induced by conflicts of interest often occur automatically and without conscious awareness, a deterrent approach based on the threat of legal punishment is clumsy public policy).

¹⁰⁵ Don A. Moore and George Loewenstein, “Self-Interest, Automaticity, and the Psychology of Conflict of Interest” (2004) 17 *Social Justice Research* 189 at 190-199; Daniel Kahneman, and Amos Tversky, “Judgment under Uncertainty: Heuristics and Biases” (1974) 185 *Science* 1124-1131, reprinted in Daniel Kahneman *et al.*, eds., *Judgment under Uncertainty: Heuristics and Biases* (Cambridge: Cambridge University Press, 1982) 3-20; Bernard Lo and Marilyn J. Field, eds., *Conflict of Interest in Medical Research, Education, and Practice* (Washington, DC: National Academies Press, 2009).

Although the empirical research on cognitive and motivational biases is relatively recent,¹⁰⁶ a core body of knowledge has been accumulated. These developments are extremely useful for understanding the phenomenon that fiduciary law aims to address, and on shaping rules that are likely to be effective in dealing with it.

The contemporary preoccupation with the appropriate understanding of a conflict of interest situation was triggered in early 1980s by the innovative work of Michael Davis.¹⁰⁷ The most relevant subsequent attempts to clarify this concept were framed explicitly in reaction to Davis' theory. As a result of these debates, several features of a conflict of interest situation have emerged as largely accepted, forming the basis of a standard view of conflict of interest.¹⁰⁸ It is important to note from the beginning that the main purpose of the standard view is to determine the moral or ethical consequences of a conflict of interest. Fiduciary law theory, instead, is concerned with understanding the existing legal rules regulating conflicts of interest in private law. Despite its idiosyncratic objective, the standard view can help legal scholars acquire an in-depth understanding of the ways in which a situation of conflict of interest affects the conflicted person.

The standard view rejects as superficial the identification of a conflict of interest situation with the principal-agent problem, which has dominated the philosophical and legal literature of conflicts of interest of the past decades.¹⁰⁹ The principal-agent problem is premised on a conflicting interests approach. Because agents are rational maximisers, they prefer to maximise their own utility, while only "satisficing" the principal's utility. Since it is costly or impracticable for the principal to monitor closely all actions of the agent, the law must compel the agent to focus exclusively on the principal's interests.¹¹⁰ The standard view, in contrast, starts from a conflict between interest and duty premise. A person has a conflict of interest if:

¹⁰⁶ Norman and MacDonald, *supra* note 98 at 459.

¹⁰⁷ Michael Davis, "Conflict of Interest" (1982) 1 *Business and Professional Ethics Journal* 17.

¹⁰⁸ The 'standard view' on conflict of interest was articulated by Michael Davis based on the work of scholars from various fields (philosophy, political theory, ethics, law). See Michael Davis, "Introduction", in Michael Davis and Andrew Stark, eds., *Conflict of Interest in the Professions* (Oxford: Oxford University Press, 2001) 3-19.

¹⁰⁹ MacDonald and Norman, *supra* note 98 at 446.

¹¹⁰ The principal-agent problem is the foundation of the law and economics, or contractarian, approach to fiduciary duties. See Frank H. Easterbrook and Daniel R. Fischel "Contract and Fiduciary Duty" (1993) 36 *Journal of Law and Economics* 425; Robert Cooter and Bradley Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 *New York University Law Review* 1045; Anthony Duggan, "Contracts, Fiduciaries and the Primacy of the Deal" in *Exploring Private Law* (Cambridge: Cambridge University Press, 2010) 275 at 278-279.

- (a) he is in a relationship with another requiring him to exercise judgment in that other's service and
- (b) he has an interest tending to interfere with the proper exercise of judgment in that relationship.¹¹¹

Judgment is a central notion in the standard view. Fundamental to the notion of conflict of interest is that someone's ability to exercise proper judgment is at risk of being affected by a personal interest or by a competing duty to exercise proper judgment.¹¹²

The concept of judgment denotes the existence of discretion, in the sense of absence of a pre-defined script or algorithm based on which a decision can be modelled. In a situation requiring the exercise of judgment, the specification of the *problem* to be solved or the *ends* to be achieved are contested, or open to interpretation.¹¹³ In contrast, decisions that do not require judgment are routine, mechanical or ministerial. They "have (something like) an algorithm."¹¹⁴ Ministerial decisions require only technical rationality. Specific theories or techniques are available to determine the most appropriate way to achieve pre-defined unambiguous goals.

Given the absence of a pre-defined pattern regarding the ends to be attained and the means to achieve them, exercise of judgment goes beyond mechanical rule following. Judgment entails knowledge, skill and insight, and the interactions of these factors can produce unpredictable results. When a decision requires judgment, different decision-makers may disagree on the ends to be pursued and on the optimal course of action, without anyone being wrong in an objective sense.¹¹⁵ In this scenario, a situation of conflict of interest impairs the decider's capacity to evaluate the possible ends and other matters of judgment, but it does not affect his overall level of competence.

¹¹¹ Davis, *supra* note 107 at 21. Consider the following example, provided by Michael Davis: "I would have a conflict of interest if I had to referee at my son's soccer game. I would find it harder than a stranger to judge accurately when my son had committed a foul... I do not know whether I would be harder on him than an impartial referee would be, easier, or just the same... I could not be as reliable as an equally competent [referee] would be." (Davis, *supra* note 108 at 16).

¹¹² Norman and MacDonald, *supra* note 98 at 455. See also W. Bradley Wendel, "The Deep Structure of Conflicts of Interest" (2003) 16 Georgetown Journal of Legal Ethics 473 at 477 (stating that a conflict of interest arises when a person is required to exercise judgment on behalf of another, and the judgment is impaired by a personal interest); Dennis F. Thompson "Understanding Financial Conflicts of Interest (1993) 329 New England Journal of Medicine 573 at 573 (defining a conflict of interest is a set of conditions in which professional judgment concerning a primary interest tends to be unduly influenced by a secondary interest).

¹¹³ Wendel, *supra* note 112 at 479-480.

¹¹⁴ Davis, *supra* note 103 at 590.

¹¹⁵ Davis, *supra* note 108 at 8; Davis, *supra* note 107 at 22: "Judgment implies discretion... A bank president does not need judgment to decide whether she (as president) should embezzle the bank's money... In contrast, a critic needs judgment to decide how good a play or actor is."

Extraneous interests interfere with judgment not as ends that a decision-maker has in view, but as factors that tend to influence the ends in view (i.e. promoting another's interests).¹¹⁶ In other words, the standard view does not start from the premise that a person who must exercise judgment for another yields to temptation and decides to pursue his own interests. It is based, instead, on the idea that the presence of such interests puts at risk the decision-maker's ability to evaluate the weight to be given to the relevant considerations on which the decision is based.

The standard view provides an essential clarification of the issues at stake in a conflict of interest: the interests that create a risk to proper judgment are not ends that the decision-maker has in view, but factors that tend to influence his evaluation of the ends in view. Personal material interest is the clearest example. The possibility of obtaining a personal unauthorised material gain as a result of a decision creates a situation of conflict, although the decision-maker does not consciously pursue his own material interests. The mere presence of the possibility of such a benefit affects the reliability of the decider's evaluation of the relevant factors on which he bases his decision. If a decision-maker consciously acts with a view to obtaining an unauthorised benefit, not only he exercises judgment inappropriately, but he also steals or misappropriates.

Interest is another essential concept for the standard view of conflicts of interest. Since perturbing interests affect the decision-making process as factors that tend to influence the ends in view, the extent of the effect of such interests on one's judgment cannot be assessed based on the actual decision taken. Because the decision-maker is the person who is charged with deciding the appropriate course of action, one cannot simply measure the deviations from a 'right' decision, which the interfering interest had caused.¹¹⁷ A decision adopted in a situation of conflict is inherently flawed, despite the conflicted person's willingness to put aside personal interests or ideological commitments. Since the effect of a conflict of interest cannot be assessed based on results, the theories of conflict of interest focus on certain kinds of identifiable interests that are particularly threatening to the exercise of judgment, such as

¹¹⁶ Davis, *supra* note 108 at 9-10.

¹¹⁷ To illustrate how interests affect judgment, Davis compared a conflict situation to dirt in a sensitive gauge. The dirt causes the gauge to work unpredictably, thus affecting its reliability (Davis, *supra* note 103 at 591). Because interests affect judgment in unpredictable ways, courts are incapable of measuring the extent to which the decision-maker's decisions deviate from the interests he was supposed to promote, or the extent to which the decision maker's judgment may have been impaired. (Andrew Stark, *Conflicts of Interest in American Public Life* (Cambridge, MA: Harvard University Press, 2000) 21, referring to judicial review of administrative decisions).

material interests or family ties. The categories of interfering interests, however, are not closed.¹¹⁸

Although in the standard view interest is an open-ended concept, it does not include just any factor that might compromise one's judgment. First, it excludes factors that may affect one's ability to use their professional competence, such as loud noise or health problems. Second, not all personal preferences can be set aside. Decision-makers cannot be required or expected to transcend all aspects of their subjectivity and act like de-humanized, deciding machines. It is not psychologically feasible to divest oneself entirely of interests that are constitutive of one's personhood. Some subjective preferences may be harmless: not every decision that a person makes on another's behalf is influenced by every interest, and not every interest renders judgment unreliable.¹¹⁹

A prohibition of all subjective beliefs, commitments, and loyalties is not only unfeasible, but it goes against the core idea of exercise of discretion. The combination of personal characteristics that is specific for each decision-maker accounts for the diversity of equally valid results that can occur in a situation involving discretion.¹²⁰ Consequently, a line needs to be drawn between legitimate factors that influence the decider's judgment and factors that have the ability to create a conflict of interest. In Stark's terms, the interests that should be encompassed by the notion of conflict of interest are those which create a normatively significant influence on the decider's judgment.¹²¹ Although what amounts to a normatively significant interest is open to debate, the standard view seems to limit interest to factors that are able to affect the reliability of a decision-maker's judgment by their simple existence as potentiality. Ultimately, what constitutes a conflict of interest in a particular situation is an empirical question. It is therefore not possible to draw an exhaustive list of what constitutes relevant interests. Financial interests and family connections, however, are firmly recognised under the standard view as normatively significant interests.¹²²

The standard view offers several key insights into the notion of conflict of interest. First, it draws a clear line between relations where parties have conflicting interests, on the one hand, and situations where an individual has a conflict of interest and duty, on the other hand. Situations where parties have interests pointing in opposite directions are ubiquitous in the markets for goods and services. They cannot be regarded as conflict of interest situations,

¹¹⁸ Davis, *supra* note 108 at 9-10.

¹¹⁹ *Ibid.* at 10.

¹²⁰ Stark, *supra* note 117 at 241; Wendel, *supra* note 112 at 486-487.

¹²¹ Stark, *supra* note 117 at 119-120.

¹²² *Ibid.*

without rendering this concept excessively broad and useless. A conflict of interest arises in an individual, as an opposition between interest and duty, rather than between individuals. An individual is conflicted not because he has a personal interest in performing or abstaining from performing any duty that he owes to another. This too would make the conflict of interest concept overly vague and meaningless. Properly understood, a conflict of interest opposes personal interest and a duty to exercise discretion over another's interests. In this scenario, interest and duty cannot be reconciled because extraneous interests affect the reliability of judgment in ways that cannot be measured or corrected against. Consequently, instructing the conflicted individual to resist the interfering interest is a false solution to a conflict situation. The person's judgment risks of being compromised even when he genuinely attempts to disregard the interfering factor. Incorporated into the fiduciary law theory, these insights have important positive and normative consequences.

5. The relevance of the standard view of conflict of interest for the law of fiduciary duties

Transposed into the fiduciary law theory, the standard view advances the current understanding of the content and purpose of fiduciary duties in several respects. First, it provides a more cogent explanation of the content of fiduciary duties and the main function that the no-conflict and no-profit rules serve. By applying insights from cognitive sciences, this novel explanation strengthens the emerging law and psychology analysis of fiduciary duties. Second, the theory advances the debate on the content of fiduciary duties, by emphasizing the core fiduciary duty to exercise proper judgment. The purpose of the strict proscriptive duties becomes clearer when they are connected with the core proper judgment duty. Third, the theory provides solid arguments against the calls for relaxing fiduciary duties in a commercial context. The fiduciary no-conflict and no-profit rules should be maintained at their current level of strictness, due to their vital role in protecting the core judgment duty. Finally, the new theory shows why a focus on temptation to act self-interestedly is misplaced. Fiduciary law, it submitted, should no longer emphasize the need to resist temptation when faced with a potential conflict of interest. The standard view convincingly argues that the focus should be placed instead on developing strategies to manage an actual or potential conflict.

5.1 The law and psychology of fiduciary duties

How does a decision-maker select relevant factors, assign their appropriate weights and reach what he believes to be the most adequate decision? An increasingly popular trend in legal scholarship uses theories developed by cognitive and behavioural sciences in order to acquire a better understanding of the existing legal rules regulating the judgment and decision making process of legal actors in various contexts.¹²³ The emerging law and psychology field improves both the descriptive and the normative legal analysis by offering a more in-depth understanding of existing legal rules regulating judgment and decision-making.¹²⁴ So far, legal scholars have applied psychology theories and insights mostly in public law, in relation to decision-making by juries, judges and administrative decision-makers.¹²⁵

The application of cognitive sciences insights to fiduciary law is in incipient stages. Gregory Alexander is one of the first scholars to adopt such an approach.¹²⁶ He used several cognitive theory concepts to rebut the traditional law and economics view that fiduciary duties are nothing but a species of contractual obligations. Alexander's theory demonstrates the discrete nature of fiduciary relations based on the model of cognitive analysis that the courts use when deciding cases involving breach of fiduciary duty. In breach of fiduciary duty cases, Alexander argued, courts have a tendency to apply top-down cognitive processes, which are theory-driven and therefore more sensitive to the judge's preconceived notions and expectations. In cases of alleged breach of contract, in contrast, courts use a bottom-up

¹²³ See Don Langevoort, "Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review" (1998) 51 Vanderbilt Law Review 1499; Avishalom Tor, "The Methodology of the Behavioral Analysis of Law" (2008) 4 Haifa Law Review 237.

¹²⁴ Jeffrey J. Rachlinski, "The 'New' Law and Psychology: A Reply to Critics, Skeptics, and Cautious Supporters" (2000) 85 Cornell Law Review 739 at 740-741. Several traditionally-minded legal scholars have expressed concerns vis-à-vis the use of psychology tools in legal analysis. See Robert A. Hillman, "The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages" (2000) 85 Cornell Law Review 717; Samuel Issacharoff, "Can There Be a Behavioral Law and Economics?" (1998) 51 Vanderbilt Law Review 179. For a rebuttal of some of these critiques see Jeffrey J. Rachlinski, *ibid.* at 743-753.

¹²⁵ See Rachlinski, *supra* note 124; Michael J. Saks and Robert F. Kidd, "Human Information Processing and Adjudication: Trial by Heuristics" (1980) 15 Law and Society Review 123; Hal R. Arkes and Cindy A. Schipani, "Medical Malpractice v. the Business Judgment Rule: Differences in Hindsight Bias" (1994) Oregon Law Review 587; Samuel Issacharoff, "Behavioral Decision Theory in the Court of Public Law" (2002) 87 Cornell Law Review 671.

¹²⁶ Gregory S. Alexander, "A Cognitive Theory of Fiduciary Relationships" (2000) 85 Cornell Law Review 767. Samet and Smith also draw on cognitive sciences to justify the strictness of fiduciary duties. Samet argues that the strict proscriptive duties apply to good faith fiduciaries due to the risk of self-deception (see Samet, *supra* note 56). In this respect, her theory is similar, albeit narrower than the one developed here. In contrast to this article, Samet does not focus on the duty side of a fiduciary conflict of interest, adopting instead a conflicting interests approach (*ibid.* at 765). Smith's approach resembles more closely the theory developed here. He states that the strict no-conflict duty protects fiduciary's judgment, but does not explore this point to the extent achieved in this article (see Smith, *supra* note 44).

cognitive method, which is data-driven and, consequently, largely insulated from the judges preconceived views.¹²⁷

Alexander's theory, while providing important new arguments for the specificity of fiduciary relationships, does not engage with the intrinsic features of legal relations that attract fiduciary duties. This article uses insights from cognitive sciences to further the analysis of fiduciary relations by focusing on their substantive features. If the notion of conflict of interest is properly understood, it becomes clear that fiduciary law rules have already incorporated these insights and have been fashioned to prevent or reduce the unwanted consequences of erroneous decision-making processes.

The standard view of conflict of interest helps lawyers understand the proper scope and justification of the firmly established fiduciary rules. It brings scientific, albeit extra-judicial, reasons why the proscriptive duties are, and should remain, very strict. As sections 2 and 3 have shown, courts have constantly affirmed the very strict nature of the proscriptive duties since the earliest stages of fiduciary law. In very rare occasions, several courts have emphasised that judges are ill equipped to investigate whether the core fiduciary duty has been breached. The standard view helps lawyers understand why this is so. The effect of self-interest on the reliability of fiduciary's judgment is unpredictable and escapes any measurement.

5.2 The duty to exercise discretion based on relevant considerations

The standard view also advances the current understanding of the content of fiduciary duties by emphasising that at the core of fiduciary's role lies a duty of proper exercise of judgment. As explained in Section 2, the currently dominant view on the content and justification of fiduciary duties fails to connect the strict proscriptive duties with the core element of fiduciary authority. When incorporated into the fiduciary law theory, the standard view addresses this problem, by showing the intimate link between extraneous interests and exercise of judgment.

The current fiduciary law recognizes that a person who has decision-making power over another's interests is bound by strict proscriptive fiduciary duties as well as by certain procedural rules in exercising that power. What the current law lacks is an understanding of the connection between the proscriptive duties and the core procedural duty. The theory

¹²⁷ *Ibid.* at 768.

developed in this article supplies this missing piece of the puzzle. The proscriptive fiduciary duties protect the core duty to identify and assess the relevant considerations in the decision-making process.

It is well established that a fiduciary is bound to exercise discretion within the objective limits of his powers and in what he believes to be the best interest of the beneficiary or the purpose for which the power was granted.¹²⁸ It is also common knowledge that an appropriate exercise of discretion imposes on fiduciaries two requirements. First, a fiduciary must exercise active discretion, in the sense of applying his mind and reaching a conscious decision regarding the need for, and the implications, of exercising any power or discretion that he holds in fiduciary capacity.¹²⁹ Second, if a fiduciary decides that it is opportune to exercise a power, he must decide where the best interests of the beneficiary lie, in the case of an administrative power, or what is the best way to achieve the purpose for which the power was given, in the case of a dispositive power. The two aspects of the exercise of judgment involve a similar decision-making process: fiduciaries must decide based on relevant considerations.¹³⁰ Although this proper judgment duty is habitually discussed in trust law contexts, it applies to any person in a fiduciary position.¹³¹

The proper judgment duty has a procedural nature. It tells a fiduciary what to do when exercising discretion, rather than what is a relevant consideration for each decision.¹³² Relevant considerations to be taken into account on a particular exercise of discretion include factors such as the nature and the purpose of the particular power to be exercised, the relationship that the power has to the other powers and duties of the fiduciary, or the nature of the transaction in which the fiduciary intends to perform.¹³³ Furthermore, fiduciaries must have regard to the already recognized relevant factors such as the wishes, circumstances and needs of beneficiaries, or fiscal considerations.¹³⁴

¹²⁸ See Lionel Smith, “Understanding the Power” in William Swadling, ed., *The Quistclose Trust: Critical Essays* (Oxford: Hart Publishing, 2004) 67-76.

¹²⁹ Thomas, *supra* note 20 at 297.

¹³⁰ See Gary Watt, *Trusts and Equity*, 4th ed. (Oxford: Oxford University Press, 2010) 373.

¹³¹ John McGhee, ed, See *Snell’s Equity*, 33rd ed. (London: Sweet & Maxwell, 2015) at [11-009].

¹³² See Thomas, *supra* note 20 at 266; *Snell’s Equity*, *supra* note 131 at [10-033].

¹³³ Paul D. Finn, “The Fiduciary Principle” in T.G. Youdan, *Equity, Fiduciaries and Trust* (Toronto: Carswell, 1989) 1 at 27.

¹³⁴ *Pitt & Anor v Holt & Anor* [2011] EWCA Civ 197 at [114]-[116]. The UK Supreme Court upheld this decision as regards the matter of actions by trustees within the limits of their powers. *Futter & Anor v The Commissioners for Her Majesty’s Revenue and Customs and Pitt & Anor v Commissioners for Her Majesty’s Revenue and Customs* [2013] UKSC 26. In discussing the duty to take into account relevant considerations, the Court of Appeal revised what had, until then, been known as the rule in *Re Hastings-Bass*. See *Re Hastings-Bass (deceased)*, *Hastings and Others v Inland Revenue Commissioners* [1975] Ch 25 at 41; *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587.

The weight that each of the relevant factors should carry in determining the course of action is a purely subjective matter.¹³⁵ As long as fiduciaries apply their mind to the importance of a relevant consideration for a particular decision, they comply with the duty of real and genuine consideration of relevant factors, irrespective of the actual outcome of their decision.¹³⁶

The current fiduciary law lacks an in-depth insight into the multiple ways in which the proper judgment duty is at risk of being breached. Clearly, a blatant procedural flaw exists when fiduciaries exercise their powers without any exercise of judgment,¹³⁷ or when they base their decision not to exercise a power on a clearly irrelevant consideration.¹³⁸ A more insidious risk of breach, however, is largely ignored by the fiduciary law literature: the negative effect that the presence of an interfering personal interest or duty has on the reliability of judgment. The standard view on conflicts of interest shows that, when a decision-maker has an actual or potential interest in the outcome of his decision, his ability to evaluate the relevant considerations is impaired in ways that cannot be measured or corrected appropriately. The effect that the extraneous interest has on the decision-making process cannot be measured due to the nature of discretion. The existence of decision-making authority means that the exercise of judgment cannot be evaluated based on results. As the standard view emphasizes, when discretion exists, people may disagree on the best course of action or objective to be pursued, without anyone being objectively wrong.

Applied into the fiduciary law theory, the standard view casts light on the subtle connection between the proscriptive duties and the proper judgment duty. This connection shows why the purpose of the proscriptive duties cannot be fully understood separately from the fiduciary decision-making process. It also provides a novel reason why the proscriptive duties should not be relaxed.

5.3 Preserving the strictness of the proscriptive fiduciary duties

The prevailing misunderstanding of the notion of conflict of interest has led an increasing number of courts and commentators to call into question the necessity to maintain the

¹³⁵ *Edge v Pensions Ombudsman* [2000] Ch 602 at 626, per Chadwick LJ.

¹³⁶ *Pitt & Anor v Holt & Anor* [2011] EWCA Civ 197 at [127] per Lloyd LJ.

¹³⁷ See e.g. *Turner v. Turner* [1984] Ch 100 at 109-110.

¹³⁸ See e.g. *Klug v. Klug* [1918] 2 Ch 67 at 71. This case can be considered also as an exercise of discretion for an improper motive or purpose (Geraint Thomas and Alastair Hudson, *The Law of Trusts*, 2nd ed. (Oxford: Oxford University Press, 2010) 377, note 84).

strictness of the proscriptive duties in a modern legal system. Jay Shepherd, one of the earliest authors of a general theory of fiduciary duties, argued that the no-conflict rule, prohibiting fiduciaries to be in a potential conflict of interest is mistaken.¹³⁹ In his view, the mere fact of being in a situation where a fiduciary is faced with a choice of using his powers in his own interest versus the interest of the beneficiary is not reprehensible. It is only when the fiduciary chooses to use the power in his interests, and therefore the conflict ceases to exist, that the fiduciary's liability arises.¹⁴⁰

John Langbein provides a different argument for relaxing the proscriptive duties in the US trust law. He claimed that the no further inquiry rule, according to which transactions involving trust property entered into by a trustee are voidable without further proof, is archaic, and must be modified.¹⁴¹ Langbein argued that neither the evidentiary difficulties nor the deterrence themes justify the maintenance of the no further inquiry rule, due to the significant modernization of civil procedure and the comprehensive requirements regarding appropriate recordkeeping by trustees. The strict prohibitions cause over-deterrence by preventing trustees from engaging in transactions that could benefit both the beneficiary and the trustee.¹⁴² Consequently, he argued, the no further inquiry rule should be replaced with a regime that allows trustees to retain profits obtained from their position, as long as they can prove, if challenged in court, that the conflicted transaction was prudently undertaken in the beneficiary's best interest.¹⁴³

The idea of relaxing the proscriptive rules found support not only from academic commentators, but also from judges. In *Murad v. Al-Saraj*,¹⁴⁴ for instance, the justices of the English Court of Appeal affirmed in *obiter* that the time may be ripe for the English courts to relax the traditional strict standard of liability imposed by the no-profit rule. Arden LJ observed that the traditional rationale for the irrelevance of the fiduciary's honesty in obtaining an unauthorized profit, namely the need for deterrence combined with the evidentiary difficulties, is obsolete and can no longer justify the stringency of the rule. A satisfactory degree of deterrence can be achieved by putting on fiduciaries the burden to prove that they acted in good faith and for the benefit of the beneficiaries. Furthermore, the

¹³⁹ Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981).

¹⁴⁰ *Ibid.* at 150-151. Shepherd accepted that, exceptionally, in several limited cases, the strict no-conflict rule should be maintained, in the sense that the fiduciary should not be allowed to be in a position where he could decide against the beneficiary's interests (*ibid.* at 150-151 and 341-342).

¹⁴¹ John H. Langbein, "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 Yale Law Journal 929.

¹⁴² *Ibid.* at 987-990.

¹⁴³ *Ibid.* at 980-981.

¹⁴⁴ *Murad v. Al-Saraj* [2005] EWCA Civ 959.

flexibility of the contemporary civil procedure rules will adequately protect the principal, and strike the right balance between the interests of the parties.¹⁴⁵ Charles Mitchell agreed with Arden LJ's statement that the no-profit rule should be relaxed, in order to prevent excessive harsh outcomes for fiduciaries. In his view, the courts should have the power to alter the severity of the rule artificially, either by narrowing the scope of the fiduciary's undertaking, so that fiduciary's gains would fall outside the scope of his duty, or by readjusting the requirement of remoteness by deeming the gains to be too remote a consequence of the breach to justify ordering the fiduciary to turn them over.¹⁴⁶

At first sight, it is tempting to agree that the inflexible no-conflict and no-profit rules are anachronistic and therefore should be adapted to the new commercial realities. Based solely on the traditional explanations for the strictness of the proscriptive duties (namely deterrence and evidentiary difficulties), one may be tempted to agree that punishing a fiduciary who obtained a gain while acting in good faith in the interests of the beneficiary is unjustifiably harsh. The relaxation arguments provided by judges and commentators, however, are premised on a superficial understanding of the notion of conflict of interest and of the main role that the proscriptive duties serve.

The proper understanding of the notion of conflict of interest that the standard view brings shows that there is a more profound reason why no actual or potential conflict should be allowed: the mere possibility of a conflict, even if not at the beneficiary's expense, affects the way in which the fiduciary exercises professional judgment over the beneficiary's interests. The standard view also argues that the only adequate way to address an actual or potential conflict of interest is conflict management, rather than abstention or evaluation of the seriousness of the conflict based on its effects on beneficiary's rights.

5.4 Addressing conflicts of interest: the shortcomings of resistance and disclosure

Applied in the context of fiduciary law theory, the standard view of conflicts of interest is also helpful in refining the current understanding of what constitutes an effective response to conflict situations. While the standard view does not prescribe a single optimal response to a conflict situation, it casts light on the shortcomings of two of the most frequently invoked responses: resisting the temptation and disclosing the conflict.

¹⁴⁵ *Ibid.* at [82].

¹⁴⁶ Charles Mitchell, "Causation, Remoteness and Fiduciary Gains" (2006) *King's Law Journal* 325 at 339.

Resisting self-interest is not an adequate solution to a conflict because people have an imperfect understanding of the effect of self-interest on their judgment and of the optimal way of correcting the biases that self-interest creates.¹⁴⁷ One line of research shows that people tend to underestimate the biasing effect of self-interest on themselves. They tend to discount self-interest as their own motivation and overestimate the role of self-interest in motivating other people.¹⁴⁸ Other studies show the opposite tendency. When people are aware of a situation where a self-interest bias could plausibly exist, they tend to assume that the bias exists and is influencing them. The more committed a decision-maker is to fairness and objectivity, the more likely he is to over-compensate for the presumed bias of self-interest, thus undermining the quality of his decision. This “incorrect correction” is caused by people’s inability to gauge the actual effect of self-interest on their own judgment.¹⁴⁹

Disclosure and consent also have shortcomings that are yet to be fully recognized in fiduciary law theory. It is generally accepted that complete disclosure will give the beneficiaries the opportunity to give informed consent to the situation of conflict, to adjust reliance accordingly, or to replace the fiduciary.¹⁵⁰ Except the latter scenario, disclosure is an effective response only if it does not affect the fiduciary’s judgment process, or, alternatively, if the beneficiary is able to correct adequately for a biasing influence.¹⁵¹ Psychological research shows that neither of these conditions may be met. Sometimes both parties may be worse off following disclosure.¹⁵²

Disclosure may have the unintended consequence of liberating a fiduciary from concerns about ethicality and give him a moral license to incorporate the conflicting interest into the decision-making process.¹⁵³ Moreover, knowing that the beneficiary is likely to discount the decision to correct for the self-interest, the fiduciary may be tempted to

¹⁴⁷ Richard E. Nisbett and Timothy D. Wilson “Telling More Than We Can Know: Verbal Reports on Mental Processes” (1977) 84 (3) *Psychological Review* 231; Timothy D. Wilson, ETA L., “Mental Contamination and the Debiasing Problem” in Dale Griffin et al, eds, *Heuristics and Biases: The Psychology of Intuitive Judgment* (NY: Cambridge University Press, 2002).

¹⁴⁸ Emily Pronin, “Perception and Misperception of Bias in Human Judgment” (2006) 11(1) *Trends in Cognitive Sciences* 37.

¹⁴⁹ Amy D. Shelton, “Incorrect Correction for the Self-Interest Bias: How Naive Theories of Bias Can Contribute to Poor Decision-Making” (BA Thesis, 2005), available at <http://library.williams.edu/theses/pdf.php?id=82>

¹⁵⁰ See Matthew Conaglen, “The Extent of Fiduciary Accounting and the Importance of Authorisation Mechanisms” (2011) 70 *Cambridge Law Journal* 548.

¹⁵¹ Daylian M. Cain, George Loewenstein, and Don A. Moore, “The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest” (2005) 34 *Journal of Legal Studies* 1 at 3.

¹⁵² Don A. Moore, et al., “Introduction” in Don A. Moore, et al., *Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine, and Public Policy* (NY: Cambridge University Press, 2005) 5.

¹⁵³ Cain et al., *supra* note 151 at 7.

counteract this adjustment by allowing self-interest to influence their decision even further.¹⁵⁴ There is also evidence showing that beneficiaries of disclosure do not adjust to counteract the self-interest. Paradoxically, beneficiaries could see disclosure as a sign of the fiduciary's trustworthiness, and may increase their confidence in the latter's judgment.¹⁵⁵ Moreover, beneficiaries of disclosure are unlikely to be sophisticated enough to be able to adjust adequately their reliance on the conflicted fiduciary.¹⁵⁶

Understanding the shortcomings of resistance and disclosure is an essential first step towards designing more effective responses to a conflict situation. The current emphasis that fiduciary law scholarship places on resisting the temptation of self-interest and disciplining the fiduciary market should be replaced with a focus on recognizing and managing conflicts of interest. Moreover, an adequate awareness of the potential unintended effects of disclosure and consent is essential when the parties to a fiduciary relation consider how to respond to a conflict situation.

6. Conclusion

The proper exercise of judgment or discretion is the law's main concern in regulating fiduciary relations. Irrespective of the label used, such as fiduciary duty, duty of loyalty, duty to exercise sound discretion, duty of real and genuine consideration, the central duty binding on every person holding a fiduciary power aims to guide the fiduciary's exercise of discretion by regulating the decision-making process.

The primacy of the decision-making process explains why fiduciary law comprises stringent proscriptive duties. Adopting a decision in a conflict of interest situation amounts to a flawed decision process, irrespective of the actual outcome of such decision. The presence of an actual or potential personal interest on the fiduciary's part in the outcome of a decision process flaws this process by affecting the fiduciary's ability to evaluate the weight that relevant factors should bear in his decision. Although the biasing effect that self-interest has on judgment is well established in other areas of social sciences, contemporary fiduciary law theory largely ignores it.

¹⁵⁴ Dave T. Miller, "Psychologically Naïve Assumptions about the Perils of Self-Interest" in Don A. Moore, et al., *Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine, and Public Policy* (NY: Cambridge University Press, 2005) 126 at 128.

¹⁵⁵ Cain, et al., *supra* note 151 at 6.

¹⁵⁶ *Ibid.* at 20-21.

One of the main causes of this oversight is the continuous attempt to find a theoretical foundation for the proscriptive duties independently of the core feature that is specific to a fiduciary position. The view that has dominated the fiduciary law theory throughout twentieth century is based on the premise that fiduciaries inevitably exploit to their advantage their superior position, and therefore need to be disciplined. The law's concern with prevention of abuse or misappropriation, however, spreads across various legal doctrines and areas. Therefore, it cannot be the central feature that sets fiduciary law apart. The essence of the fiduciary principle is the authority to decide how to advance the best interest of another, or promote certain abstract purposes. A fiduciary must not exercise this authority capriciously. He must identify and evaluate the considerations that are relevant for each exercise of discretion. Recent research in various academic fields concerned with conflicts of interest shows that self-interest can affect the decision-maker's ability to evaluate the relevant considerations in ways that often escape measurement or control. The main reason why fiduciary law is concerned with the management of actual or potential situations of conflict is not prevention of abuse by stifling temptations. It is protection of beneficiary's right to fiduciary's unencumbered and genuine judgment. Disciplining legal actors and reinforcing the general confidence in legal relations are, at best, secondary effects of fiduciary law and, indeed, of any private law rules.